UNITED STATES
TELEPHONE
ASSOCIATION

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February 14, 1997

William F. Caton
Secretary
Federal Communications Commission
1919 M Street, NW - Room 222
Washington, DC 20554

Re: CC Docket 96-262
Access Charge Reform

Dear Mr. Caton:

Enclosed please find 4 diskettes containing a copy of the USTA Reply Comments and Attachments 1 through 13 (except Attachment 9, which is not available in electronic format) in response to the Commission's Notice of Proposed Rulemaking in CC Docket 96-262.

Should you have any questions, please feel free to contact me at (202)326-7266.

Sincerely,

Frank McKennedy

Frank McKennedy
Director Legal & Regulatory Affairs

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Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
	)	
Access Charge Reform	)	CC Docket No. 96-262
	)	
Price Cap Performance Review for Local Exchange Carriers	)	CC Docket No. 94-1
	)	
Transport Rate Structure and Pricing	)	CC Docket No. 91-213
	)	
Usage of the Public Switched Network by Information Service and Internet Access Providers	)	CC Docket No. 96-263

REPLY COMMENTS OF THE UNITED STATES TELEPHONE ASSOCIATION

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SUMMARY

In its reply comment, USTA provides a rebuttal to those parties supporting a prescriptive approach to access charge reform. On behalf of USTA, Alfred E. Kahn (Attachment 1) states that the prescriptive approach will jeopardize achievement of the goal of the Act to accelerate the development of and investment in an advanced telecommunications infrastructure under conditions of efficient, dynamic competition. Reducing access charges rapidly to hypothetical TELRIC/TSLRIC levels ignores both historical and current costs of the incumbent LECs. Failure to recover those costs undermines both the incentive and ability of the incumbent LECs to engage in the necessary large investments in the public network which all providers and customers will continue to rely heavily upon, while also diluting the incentive of new competitors to enter on a facilities basis. This will have a damaging effect on the incentive of incumbents and competitors alike to engage in creative innovation.

In addition, under a prescriptive approach, competitors will be able to further their competitive advantage in both the interexchange and local markets since they are not subject to the same rigid regulatory requirements as the incumbent LECs. Competitors are permitted to resell incumbent LEC services at sharply reduced prices and to use incumbent LEC unbundled network elements priced below actual cost to offer service only in the most lucrative markets. The asymmetric nature of the prescriptive approach will harm consumers because they will not receive the full benefits of an efficient competitive market. A prescriptive approach will perpetuate distorted pricing which will not provide the proper economic signals to either consumers or competitors which is essential to the continued development of a healthy economic

market.

The arguments of the proponents of a prescriptive approach are Orwellian in nature, as aptly characterized by Gregory Sidak and Daniel Spulber in their reply affidavit. (Attachment 2). Markets for interstate access which already show strong competition are described as nonexistent. Regulators are told that competitive markets will be more competitive if they are regulated more heavily. Price cap regulation with all of its incentives for efficiency is abandoned under the guise of reinitialization. The historic costs of providing the current network infrastructure upon which competitors and customers rely and the cost characteristics of maintaining that network on a going-forward basis are declared imprudent and inefficient. Regulators are advised that they can ignore the social contract upon which the asset-specific investment was made. The common costs of operating the exchange network are said to be nonexistent since LECs now sell elements. Customers are told that they will save $45 billion under a prescriptive approach, omitting the fact that such savings cannot be realized without the full participation in the long distance market of the incumbent LECs and the institution of rate rebalancing necessary to reduce long distance rates. Customers are also told that interexchange carriers have reduced long distance prices, omitting the fact that such reductions have only applied to the largest business customers. These arguments ignore reality.

USTA provides data which depicts the competition which already exists. (Attachments 5-8). Richard Schmalensee and William E. Taylor, (Attachment 3) as well as Sidak and Spulber, discuss the problems with using TELRIC-based pricing which does not recover any of the incumbent LEC's shared or common costs. Pricing at TELRIC sends the wrong economic signals. TELRIC is not an appropriate pricing standard because it is based on hypothetical costs, not the actual costs which were used to build the network or the actual costs incurred in maintaining it.

Sidak and Spulber also discuss the legal implications of the prescriptive approach which result from failing to provide recovery of legitimately incurred costs. The relevant case law on impermissible takings require the recovery of all legitimately incurred costs.

Jeffrey Rohlfs, Charles Jackson and Ross Richardson (Attachment 4) dispel arguments made that the problem of inadequate capital recovery is insignificant and that, in any event, price cap LECs should not be allowed to recover those amounts.

Laurits Christensen discusses the conceptual and computational errors in the X-factor recommendations of AT&T, MCI and others. (Attachment 12). The AT&T analysis incorrectly measures every component of productivity (i.e., capital input, labor input and materials, rents and services input, and output). MCI does not even measure productivity, it only seeks to eliminate all of the incentives for increased efficiencies which the price cap LECs have earned in the past five years. Christensen also states that the TFP is the preferred method to reflect the impact of rate restructuring.

Randall Billingsley (Attachment 13) refutes the arguments of AT&T, MCI and others regarding the need to reinitialize the current rate of return. He concludes that a represcription should not take place given the increasing risks as a result of the Act and the uncertainties associated with its implementation.

Schmalensee and Taylor confirm that USTA's market-based approach is consistent with sound economic principles. They refute arguments that such an approach will provide opportunities for anti-competitive behavior such as price squeeze. The Phase I trigger, a state-approved interconnection agreement, shows that the level of sunk costs needed to enter the market do not pose a barrier to entry. With an agreement, a competitor will not have to invest in loops, switches or transport, if the competitor wins the customers. The competitor will also have access to nondiscriminatory operations support systems. The precondition that the customer is won only applies to the use of an unbundled local switch. This precondition does not pose any significant barrier. Given the opportunities that competitors will enjoy, it is essential that regulation be symmetrical in Phase I. Any delay will only impede the development of a healthy, competitive market and delay the benefits of such a market to customers. The price cap basket structure should be simplified as proposed by USTA, Part 69 codification should be eliminated for price cap LECs, and deaveraged switched access rates, volume and term discounts, contract-based tariffs as well as the deregulation of new services should be permitted.

In Phase II, where competition has been shown to exist, services should be removed from price cap regulation since competition will be sufficient to prevent anti-competitive behavior. Forbearance is required any time the Section 10 standards are met. USTA demonstrates that forbearance is warranted now for special access, collocated dedicated trunked transport, directory assistance and services in the Interexchange Basket.

USTA supports the recovery of CCL charges on a flat rate basis. A flat rate charge will not conflict with Section 254(g) of the Act. IXCs can average a flat rate CCL charge into their rates just as they average disparate per minute CCL charges, property taxes, depreciation, electricity and labor costs today.

The transport rate structure must ensure the full recovery of the TIC. Other rate structure changes, for SS7, new technology, and local switching should not be mandated.

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COMMENTS
OF THE
UNITED STATES TELEPHONE ASSOCIATION

The United States Telephone Association (USTA) respectfully submits its reply to the comments filed January 29, 1997.

I. INTRODUCTION. (Paragraphs 41-49).

In its comments, USTA proposed a plan to allow the market to transition access rates to competitive levels. This is the only approach which will ensure that a healthy competitive market continues to evolve. Since incumbent LECs must compete with both facilities-based carriers, resellers and carriers that supply access through the use of unbundled network elements, regulatory relief is warranted. The Commission should not substitute its judgment for that of the market to establish competitive prices. Such action is contrary to the 1996 Act which eliminated monopoly regulation and replaced it with a competitive paradigm.

Phase I of a market-based approach should, at the very least, be designed to reflect the realities of the current market and the requirements of the 1996 Act. A state-approved interconnection agreement is sufficient evidence that barriers to entry in the local market have been removed. Incumbent LECs should then be permitted the flexibility to offer volume and term discounts, to deaverage switched access service rates by geographic area and by class of customer, and to offer contract tariffs and responses to RFPs. Price cap LECs should no longer be subject to the current Part 69 rules. Flat rate recovery of carrier common line charges and flexibility to recover other rate elements in the most economic manner will provide a rational means to remove some of the uneconomic components of current access prices. The current price cap basket structure should be simplified. Services which are highly competitive, such as the Interexchange Basket services identified in USTA's comments, special access and collocated dedicated (direct) trunked transport, should be forborne from current tariffing requirements. The current price cap rules should be amended to remove sharing and the consumer productivity dividend. A fixed X-factor, based on the five year average TFP, should be adopted which takes into account the impact of rate structure changes.

In Phase II, services should be removed from price cap regulation in specific geographic areas (smaller than a study area), when actual competition is present. The existence of actual competition can be shown in a number of ways, such as through evidence that barriers to entry are removed, that a state-approved interconnection agreement exists, that NXX codes are assigned to competitors, that minutes are being exchanged, as well as through a listing of competitors in a market, a listing of the services offered by competitors and a description of the geographic areas served by competitors. Such evidence will show that a competitor may enter the market, that substitutable services are available from a competitor and that customers are utilizing such services. Under Phase II, tariff filings should be permitted on one day's notice without cost support. Forbearance is required any time the criteria contained in Section 10(a) are met.

Regulators are obligated to provide incumbent LECs with a reasonable opportunity to recover all economic costs. Prices based on current TSLRIC or TELRIC cost models do not reflect the costing requirements of the Act and, thus, will not provide that opportunity. All legitimately incurred costs, including those identified and quantified by USTA in the various components of the TIC, the depreciation reserve shortfall, as well as the costs allocated to the interstate jurisdiction through the operation of the separations rules, must be recovered. Pricing must be compensatory to avoid committing an improper taking of property under the Fifth Amendment of the Constitution.

USTA also discussed the importance of pricing flexibility for rate of return companies. (¶¶ 50-53). It will be too late to provide them with the ability to respond to competition, if these companies must wait until a global firm like AT&T, MCI or Time Warner enters their serving area. AT&T observes that rate of return companies should be subject to the same arbitrary access rate reductions as it proposes for the price cap LECs.[1] Of course the current costing

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[1]AT&T at 20.

models which AT&T has relied on to determine what it believes are sufficient prices do not include any data for rate of return companies. The Joint Board strongly recommended that it would be inappropriate to apply such models to the vast majority of rate of return companies which serve rural areas and concluded that rural companies should be exempt from the application of cost proxy models, including the Hatfield model, for determining universal service support. The Commission has stated that reform of the access charge system for rate of return companies will be dealt with in another proceeding. There is no need for the Commission to prejudge any such issue here, particularly since rate of return companies have not had adequate notice that such an issue would be considered.

As has been the case since the inception of the Commission's proceeding in CC Docket No. 94-1, competitors do not want incumbent LECs to be granted any regulatory relief. The prescriptive approach advocated by competitors increases the regulatory burden on incumbent LECs so that competitors may further their competitive advantage in both the interexchange market and the local market. Competitors have pursued this strategy in order to increase their own profits without considering the impact on customers. The Act recognizes that efficient competition will not develop unless incumbent LECs are relieved of regulatory constraints. Thus, the regulatory burdens on incumbent LECs must be removed.

More important, the Act recognizes that investment in the telecommunications infrastructure must be sufficient to ensure that all consumers have access to services at comparable prices regardless of whether they live in an urban area or a rural area. Incumbent LECs are investing approximately $20 billion per year in the infrastructure. If incumbent LECs are not provided an opportunity to recover the interstate portion of that investment through access rates, they will have no incentive and no ability to maintain current levels of investment.

Facilities-based competition in particular requires private investment. If the Commission prescribes huge reductions in access prices totaling $10 or $11 billion as AT&T and MCI have suggested, prices will be too low to provide incentives for price cap LECs to invest in the infrastructure. This will also impact competitors. Firms will have no incentive to become facilities-based competitors if they do not believe that those costs will be recovered. "...[N]ot only do inaccurate prices give the wrong incentive for use, they also give the wrong incentive for investment. For example, if local service is underpriced, new entrants have no incentive to invest the capital necessary to provide this service. Such a result will lead to less capital investment in the local loop and may forestall competition in this market."[2] Of course, to date, competitors have not volunteered to make the same level of investment in the infrastructure as the incumbent LECs.

In Attachment 1 appended hereto, Alfred Kahn states that the prescriptive approach will jeopardize achievement of the goal of the Act to accelerate the development of and investment in an advanced telecommunications infrastructure under conditions of efficient, dynamic competition.[3] According to Dr. Kahn, by reducing access charges rapidly to hypothetical TSLRIC/TELRIC levels, the prescriptive approach ignores both historical and current costs of

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[2]Citizens for a Sound Economy at 3.

[3]Statement of Alfred E. Kahn on FCC's Proposed Reforms of Carrier Access Charges, Attachment 1.

the incumbent LECs. Failure to recover such costs undermines both the incentive and ability of the incumbent LECs to engage in the necessary large investments in the public network which all providers and customers will continue to rely heavily on, while also diluting the incentive of new competitors to enter on a facilities basis. This will also have a damaging effect on the incentive of incumbents and competitors to engage in creative innovation.

Competitors are permitted to resell incumbent LEC services at sharply discounted prices or to use incumbent LEC unbundled network elements priced below actual cost to offer service in only the most lucrative markets. Preventing incumbent LECs from recovering their interstate costs by mandating prescriptive pricing rules will ultimately jeopardize universal service, undermine incumbent LEC efforts to maintain high quality and reliable service, deter investment in the network by LECs and their competitors (no company will want to invest if they do not perceive that they will be allowed to recover all of their costs) and result in an unconstitutional taking. USTA will discuss these issues in its reply.

II. THE PRESCRIPTIVE APPROACH IS HARMFUL TO CONSUMERS, IS CONTRARY TO THE ACT AND COMMISSION POLICIES AND IS UNLAWFUL. (Paragraphs 218-240).

As explained above, it is not surprising that competitors supported the Commission's prescriptive approach to access reform. By requiring that price cap LEC prices reflect TSLRIC and/or TELRIC cost methodologies, price cap LECs will not be able to recover their economic costs. Competitors, on the other hand, will be able to further their competitive advantage in both the interexchange and the local markets since they are not subject to the same rigid regulatory requirements. Asymmetric regulation will harm consumers because they will not receive the full benefits of an efficient competitive market. The distorted pricing which the prescriptive approach perpetuates will not provide the proper economic signals to either consumers or competitors to permit them to make economic decisions. In addition, this approach is contrary to the Act and to current Commission policies and will result in an unconstitutional taking of property. In their Reply Affidavit appended hereto, Sidak and Spulber aptly summarize the Orwellian nature of the arguments of AT&T and others supporting the prescriptive approach:

> This argument, advanced by AT&T, can be summarized in the slogan, "Regulation is Competition." Such a proposition exemplifies what George Orwell, in his novel *1984*, called *doublespeak*. Markets for interstate access that already exhibit dozens of rivals cannot be redefined as "nonexistent". Regulators do not make demonstrably competitive markets more competitive by regulating them more heavily. Nor, as AT&T urges, can the Commission's commitment to LEC price caps for interstate access be disregarded by euphemistically calling the repudiation of existing caps "reinitialization". Nor can the historic costs of providing network infrastructure, or the cost characteristics that inhere to such a network on a going-forward basis for the remainder of its useful life, be said not to have been "prudent" or "efficient" when asset-specific investments were made, or not to have resulted from a bargain between regulators and the LEC. Nor do the common costs of operating a local exchange network disappear by saying that a LEC is now in the business of selling elements rather than services, and that elements have few if any costs in common with one another. These are all examples of attempts to rewrite history and contort economic logic and terminology to produce results that would turn the sound application of economic principles on its head.[4]

A. The Prescriptive Approach is Detrimental to Consumers.

As many commenters explain, the prescriptive approach will result in a severe reduction in the revenues of the price cap LECs. U S WEST estimated a loss of over $1.3 billion

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[4]J. Gregory Sidak and Daniel F. Spulber, Reply Affidavit, Attachment 2, at 2-3. [Sidak and Spulber].

comparing TELRIC unbundled annual revenues with 1995 regulated revenues.[5] GTE estimated a loss of approximately $1.48 billion.[6] In addition, if switched access for the price cap LECs was set at $0.01/MOU, the LECs would see a revenue reduction of approximately $6.5 billion.[7] As noted above, the loss in revenues will chill incentives to invest in the infrastructure and will preclude investment at current levels. Such a result will threaten the maintenance of high quality, reliable service, will stifle innovation thereby reducing consumer options and, ultimately, will jeopardize universal service. The prescriptive approach will only serve to eliminate the benefits of competition which the Act intends to provide to consumers.

In an affidavit attached to AT&T's comments, the argument is put forth that the prescriptive approach will save consumers over $45 billion.[8] As Schmalensee and Taylor explain, this assertion is wholly unsupported by the facts.[9] The significant benefits to consumers described by AT&T can only be realized by increased competition in the long distance market by the LECs, combined with rate rebalancing to reduce long distance rates to more competitive

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[5]U S WEST at 14.

[6]GTE at vi.

[7]This rate is used for illustrative purposes and does not represent any type of estimate of the cost of switched access. The revenue reduction is derived from the total local switching, carrier common line, transport interconnection, information surcharge, tandem switching and common and dedicated transport revenue from the proposed rates in the price cap LECs' 1996 annual filings.

[8]AT&T at 3.

[9]Richard Schmalensee and William E. Taylor, "Economic Aspects of Access Reform: A Reply", Attachment 3 at 8-9. [Schmalensee and Taylor].

levels. "To imply that these figures are related to reductions in carrier access charges in and of itself is highly misleading."[10]

Further, it cannot be assumed that the benefits of any reductions in access charges will ever reach consumers. In the past, the three largest interexchange carriers have refused to pass through reductions in access charges. To date, consumers have been denied the full benefit of the $9 billion dollars in access charge reductions made by the price cap LECs. Instead, these three companies have raised prices for their average customers simultaneously five times over the past six years. As explained in a recent article in the *Wall Street Journal*, "[t]hat is why AT&T has been raising its basic rates in the past couple of years, and why rivals have been following in lockstep. They aim to offset a falloff in revenue brought about by discounting. Consumer watchdogs have long decried the fact that more than half of AT&T's 80 million household customers still pay high basic rates, apparently unaware of or uninterested in, cheaper plans."[11] There is no assurance that subsequent reductions will be used to reduce long distance prices for the average customer instead of to increase IXC profits.[12] While AT&T promises to pass through reductions in access charges to its customers,[13] any such assurance is illusory. To

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[10]*Id.*

[11]"Best Phone Discounts Go To Hardest Bargainers," *The Wall Street Journal*, February 13, 1997 at B1.

[12]*See, also,* Pacific Telesis *Ex Parte*, CC Docket No. 96-262, February 7, 1997. Pacific provides data showing the reduction in Pacific's intrastate access charges, the resulting reduction in AT&T's intrastate access expense and the increase in AT&T's intrastate rate of return.

[13]AT&T at 14.

ensure that consumers receive the benefits of access charge reductions, the Commission should require the IXCs to pass through such reductions on a dollar-for-dollar basis.

In a recently published study, MCI claims that it has reduced its revenues per minute to reflect reductions in access charges.[14] Schmalensee and Taylor have examined this study and have found that MCI has misrepresented and/or omitted certain facts underlying its conclusion. For example, MCI has mistakenly characterized reductions in average revenue per minute as reductions in access prices. In the current telecommunications environment, there are many reasons to expect average revenue per minute to overstate true price reductions. MCI has also miscalculated average revenue per minute. MCI's data does point out that the largest business customers have benefited from reductions in price. Of course, these customers are able to take advantage of the limited competition which currently exists in the long distance market to negotiate with IXCs regarding price. Residential customers have not experienced such reductions.

Pricing regulation which is not based on the actual cost of providing service will send incorrect price signals to consumers and to competitors resulting in inefficient decisions and higher total costs. Maintaining prices that are too low will inhibit competition and harm consumers. If a new entrant cannot cover its costs, it will not have any incentive to enter a

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[14]MCI, "True Competition in the Long-Distance Market", January 27, 1997. MCI does recognize the chilling effect which regulation can have on investment. "If the regulatory climate is right, MCI has plans in place to invest an additional $700 million by the end of the year, providing service to both business and residential customers in over 30 markets in 23 states", at 23.

market thereby depriving consumers of service options. "Mandating an arbitrary and unsupported reduction in the current margins of the access markets will unnaturally retard the emergence of access competition."[15] Non-market-based pricing also leads to arbitrage which allows competitors to take advantage of the pricing discrepancies in different markets. Simply lowering access charges for IXCs, as AT&T and MCI propose, will not benefit consumers. Using a market-based approach as proposed by USTA will enhance efficient competition. Efficient competition will benefit consumers.

B. The Prescriptive Approach is Contrary to the Telecommunications Policies Established in the Act and to Current Commission Policies.

As noted above, the Act contemplates sufficient investment in the infrastructure to ensure that services, including enhanced services, reach all consumers regardless of their location.[16] An arbitrary reduction in access charges will only provide disincentives to invest in the infrastructure. The Act also opens the local exchange market by eliminating barriers to entry. Both IXCs and CLECs have already received authorizations to provide local service and have negotiated interconnection agreements. The Act creates a competitive paradigm that allows private parties to negotiate rates. The Act does not authorize the Commission to interfere with this process by arbitrarily setting access prices at levels that are so far below cost they are not compensatory. In fact, the Act requires that the state commissions establish charges for the interconnection of facilities and equipment and for network elements that are based on the cost of

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[15]ALTS at 22.

[16]Section 254(b).

providing the interconnection or the network element and are non-discriminatory. Prescribing rates based on the current TELRIC models is contrary to all of these provisions of the Act.[17]

In addition, the Act requires streamlining and the elimination of unnecessary regulation. Contrary to the assurances of AT&T, the prescriptive approach will require greater regulatory intervention. "Such increased regulatory involvement likely would place paperwork and other administrative burdens on both the Commission and reporting carriers. Of course, these burdens ultimately are shouldered by ratepayers or taxpayers."[18] In addition, the Commission would have to gather sufficient information to estimate the correct prices for many different services in the market, a task which can best be performed by the carriers competing for customers in the marketplace. Unnecessary regulation increases the costs of providing service at a time when price cap LECs are reducing costs in order to compete with unregulated entities. In Attachment 1 of USTA's January 29, 1997 comments, examples in the railroad and banking industries are used to indicate the dangers and costs to society in delaying regulatory changes and eliminating unnecessary regulatory constraints.[19]

The prescriptive approach is also contrary to the objectives of price cap regulation. The Commission adopted price cap regulation to sharpen the competitiveness of the industry in the

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[17]Section 252.

[18]Citizens for a Sound Economy at 5.

[19]Schmalensee and Taylor, "Economic Aspects of Access Reform", USTA Comments, CC Docket No. 96-262, January 29, 1997, Attachment 1 at 23.

face of increasing competition, both nationally and internationally.[20] Price cap regulation has worked, as expected, to increase efficiency incentives and lower prices, just as the competitive market. It does not make sense to introduce more regulatory constraints when the Act and the Commission have accelerated the pace of competition.

C. TELRIC Costs Are Not Economic Costs.

In their Reply Affidavit, Sidak and Spulber provide a detailed rebuttal of the arguments set forth in AT&T's comments regarding the use of TELRIC costs to price access.[21] They explain that TELRIC pricing does not reflect incumbent LECs' total direct costs because it does not recover any of the incumbent LECs' shared or common costs. They dispel the notion that incumbent LECs can make up their losses elsewhere:

> Although appealing on the surface, such a suggestion requires that earnings from other services be sufficient to cover shared costs and common costs. Such an unfounded belief can easily fail to correspond to market conditions. Competition may, but need not, lower margins on those services identified by competitors in their unbundling requests; it is just as likely to do so on the remaining services. Indeed, with TELRIC pricing, competitors are most likely to purchase those services that would have a markup in a competitive market, so as to free-ride on the incumbent LEC...The market-allowed contribution of "other services" cannot be predicted *a priori*. What *is* certain is that a firm that does not cover its common costs and shared costs will not remain in business for very long.[22]

Sidak and Spulber demonstrate how TELRIC will create cross subsidies when multiple services are available that have shared and common costs. They point out that subsidizing

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[20] *LEC Price Cap Order*, 5 FCC Rcd 6786, 6790 (1990).

[21] Sidak and Spulber at 4-30.

[22] *Id.* at 6.

services by pricing at TELRIC sends the wrong economic signals. It encourages resellers to enter the market based on underpriced facilities and discourages facilities-based competition. "Why should an entrant seek a competitively priced alternative when it can free ride on the incumbent LEC's facilities at prices that are below cost?"[23] TELRIC pricing also creates incentives for excessive unbundling. "Competitors not only avoid paying a portion of shared costs and common costs, but also have an incentive to request ever finer partitions of services, and interconnection at every technologically feasible point, so as to shift costs farther away from incremental costs and into shared and common costs. This strategic opportunity allows competitors to free ride on the incumbent LEC."[24] TELRIC pricing also fails to include increases in shared costs and common costs that result from unbundling and creates an incentive to lower such costs. Shared and common costs represent the efficiencies of economies of scope. Ignoring these costs will result in the inability to reflect the efficiencies associated with them.

Schmalensee and Taylor agree that TELRIC is not appropriate for pricing purposes.[25] They explain that basing prices on the TELRIC of a *hypothetical* system built by either the incumbent or another carrier starting with a blank slate and using the most efficient current technology fails to represent how real networks are produced and therefore, biases the results. In addition, they discuss how TELRIC pricing fails to recover ongoing costs or burdens asymmetrically borne by incumbent LECs and sunk costs.

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[23]*Id.* at 8.

[24]*Id.* at 10.

[25]Schmalensee and Taylor at 3-16.

D. The Prescriptive Approach Will Not Permit Incumbent LECs an Opportunity to Recover All of their Legitimate Costs and Is, Therefore, Unlawful.

Sidak and Spulber observe that the commenters that oppose incumbent LEC recovery of all of its economic costs distort the need and ability of the LECs to recover those costs.[26] They expose the fallacy of AT&T's arguments regarding so-called misallocation of investment in network improvements.[27] They correct AT&T's misapprehension regarding the effect of price cap regulation on the regulatory contract.[28] They correct AT&T's assumption that incumbent LECs could have received accelerated depreciation.[29] They refute AT&T's statements that LEC investment is imprudent and inefficient.[30] Sidak and Spulber point out that full recovery of costs is not tantamount to indemnification.[31] There is no evidence to support allegations that investment is inefficient. Such investment was approved by regulators as prudent. Pricing at TELRIC will not eliminate any inefficiencies that were incurred incrementally with respect to the provision of a network element.

Sidak and Spulber address the fact that those opposing incumbent LEC recovery ignore the relevant case law on impermissible takings, particularly the Supreme Court's decision in

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[26]Sidak and Spulber at 30-50.

[27]AT&T at 31.

[28]*Id.* at 32.

[29]*Id.*

[30]*Id.* at 33.

[31]*Id.* at 29.